

Enabling enterprise

Dr Joshua Hall explores how personal and economic freedom underpin growth and prosperity by unlocking fruitful connections between government institutions, economic policies and entrepreneurial activities

Could you explain how you came to study economics?

After earning my bachelor's and master's degrees in economics from Ohio University, I worked on Capitol Hill for the Joint Economic Committee and for a state-based think tank. While working for the think tank, I also taught as an adjunct professor for a small liberal arts college and realized I really loved teaching, which brought me to West Virginia University for my PhD. My first full-time academic job was at Beloit College, a liberal arts college in Wisconsin. I eventually earned tenure at Beloit and was holder of the Elbert H Neese Chair before returning to West Virginia University as an Associate Professor of Economics in 2013.

I feel like I have always thought like an economist. Taking an economics course from Richard Vedder at Ohio University provided an academic discipline and framework to a way of thinking that was already very comfortable to me.

What motivated your latest research into entrepreneurship and its link with economic growth?

Economic freedom leads to higher income levels and living standards, but what is the mechanism? Building on the work of William Baumol on the difference between productive and unproductive entrepreneurship, I realized that economic freedom channels individual entrepreneurial effort towards activities that lead to growth. My primary focus has been to see what areas of economic freedom are most conducive to entrepreneurship and which might be negatively related.

How does your work fit within the overall landscape of research into economic freedom?

As a co-author of the *Economic Freedom of the World (EFW)* index, most of my time is spent measuring the economic freedom of 152 countries annually. Measuring economic freedom, however, means that you also get asked to referee a large number of papers using the EFW index. In terms of empirical research, most using the EFW employs the large panel data approach. Personally, I would like to see more 'thick' case study research, like Scott Beaulier's work on Botswana.

Could you highlight some key findings from research on economic freedom to date?

A key finding, in my opinion, is the importance of the 'rules of the game' for entrepreneurship. It is really important that government protect property rights and maintain the rule of law to give entrepreneurs a stable and predictable policy environment in which to take

their goods or service to potential customers. Another interesting finding is that areas that have more economic freedom not only have more business start-ups, they also have more business failures. That is important to note, because we often forget from where the capital and talent for new enterprises comes.

What are the potential implications of your research?

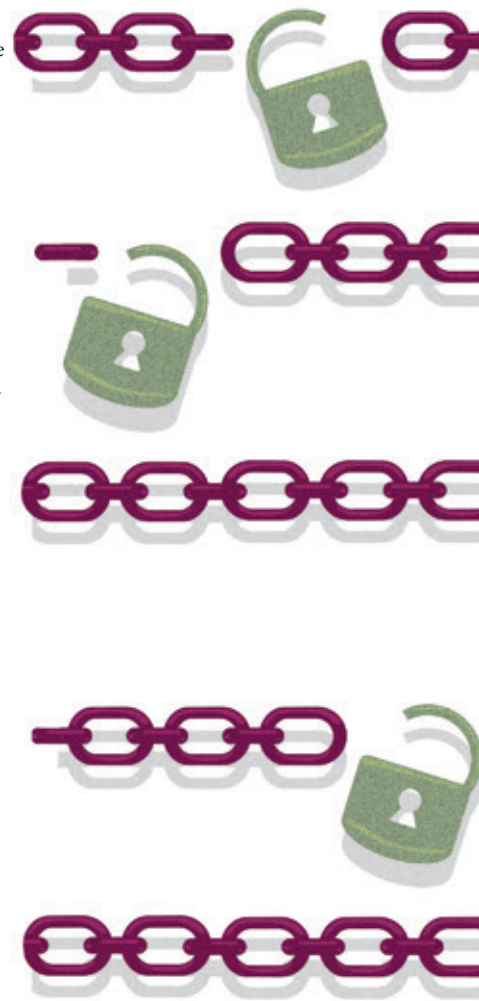
The great thing about increasing economic freedom is that it taps into all this knowledge that is out there in people's heads. In Singapore, entrepreneurs don't keep ideas for very long because it is easy to start a business there. In countries with much more onerous business regulation, however, who knows how many great ideas never get to the marketplace? The great thing about increasing economic freedom is that it lowers barriers to entry for everyone equally, which, unfortunately, is why it is often difficult to achieve since some individuals profit from the exclusion of others.

When teaching, how important do you find case studies and simulations for engaging the students of today tomorrow?

We need to utilize simulations more in economics to get students' hands dirty. From my experience teaching students to write for a public audience, I've found that they love to dive into a project that has a real-world connection or output.

How do you see your research area developing over the next few years?

I think we'll be seeing more papers exploring the relationship between economic freedom and the gender and racial gaps in entrepreneurship.



Free to succeed or fail

According to comparative analyses conducted at **West Virginia University**, an environment of economic freedom is the primary force for generating higher income levels, rates of economic growth and stimulating productive entrepreneurial activity

AN ECONOMIC SYSTEM which has the freedom to engage in competitive markets and hold property privately, where state regulation is an enabler and not overly restrictive, underpins the achievement of the comparatively higher standard of living of people in certain countries. For example, people's wellbeing in countries such as South Korea, Hong Kong and the US contrasts sharply with that in North Korea, China and Cuba.

Since 1996, the *Economic Freedom of the World (EFW)* report has measured the 'economic freedom' of countries on a scale of zero to 10 annually. The report uses 42 variables to summarize economic freedom in five broad areas: the size of government (taxation and scale of expenditure), the degree of government control of the money supply and inflation, protection of individuals' property rights and enforcement of contracts, the freedom to trade internationally, and, lastly, the amount of regulation on credit, labour and business. The EFW reports have tracked changes in countries' performance in these terms going back to 1970, showing clear links between changes in economic freedom and economic prosperity and wellbeing.

Dr Joshua Hall, Associate Professor of Economics at West Virginia University, is a contributor to the *EFW* report and is also the newly-appointed Editor-in-Chief of the *Journal of Entrepreneurship and Public Policy*. His own research centres on applied microeconomics, with an emphasis on economic freedom, public finance and entrepreneurship. Hall also recently published a compendium of essays, *Homer Economicus: the Simpsons and Economics*, in which principles and questions in economics, primarily at the microscale, are discussed in relation to the long-running television show *The Simpsons*.

ENABLING ENTREPRENEURSHIP

An entrepreneur, literally translated from the old French, is someone who undertakes action; now the word is understood to mean someone with creativity and initiative who undertakes risk in pursuit of a revolutionary business venture. It is this risk-taking behaviour that makes entrepreneurs key players in economies, fostering both progress and economic growth.

In an early study of entrepreneurial activity, Hall explored the effects of measures of both personal and economic freedom on entrepreneurship. His findings indicated that while in aggregate these freedoms were fundamental to fostering new start-up businesses, fiscal policy was the dominant factor: levels of government taxation and expenditure influence entrepreneurial decision-making more than regulation or any other economic or personal control mechanism. And an increase of one standard deviation in the economic freedom index of a state will lead to more than 100 new business start-ups per month for every 100,000 residents.

In exploring the relationship between elements of government policy that are conducive to starting new businesses, Hall found that the 'business climate' indices available for the 50 US states were mostly inadequate in predicting entrepreneurship levels. An exception to this, that did have value in Hall's opinion, was the 'Days to Pay' measure that calculates the total tax burden for residents in each state, which he believes could be used to attract entrepreneurs to do business in certain states. For his analyses, Hall has therefore developed more reliable methods to predict entrepreneurial activity. The main parameter he uses is the rate of growth of new sole proprietorships or businesses over time, supplemented by other standard variables, such as the quality of government institutions.

Hall also includes a large number of factors at population scale, ranging from personal variables such as educational attainment, median age and race to wider variables such as available domestic credit, population density, property crime rates and gross domestic product per capita: "I employ regression analysis in a lot of my work, especially spatial econometrics," he explains. "While I have also conducted case studies or qualitative research, it is really about the particular question at hand and which research approaches are most appropriate."

THE RULES OF THE GAME

From Hall's analyses over the last few years, the rate of entrepreneurship within an economy – at state or federal scale – and consequent economic growth, is

Levels of government taxation and expenditure influence entrepreneurial decision-making more than regulation or any other economic or personal control mechanism



Woodburn Hall
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primarily determined by the prevailing 'rules of the game'. Government interference beyond protecting property rights and the rule of law can have unintended consequences for entrepreneurship, inhibiting entrepreneurs from identifying, evaluating and exploiting opportunities to create new goods or services. Though entrepreneurial people exist in all societies and circumstances, it is the economic environment they inhabit that either stimulates or constrains their risk taking behaviour. In fact, through comparative assessment of economic freedom in different parts of the US and countries across the world between 1995 and 2000, against rates of entrepreneurship, income and economic growth in each, Hall has found that a one-point increase in the economic freedom index consistently equates to more than a two per cent increase in the number of entrepreneurial start-ups. Notably, this increase occurs irrespective of other geopolitical and socioeconomic factors and independently of the nature of the prevailing labour and product markets.

A consequence of an enhanced rate of entrepreneurship in economically free states and countries, Hall notes, is that the rate of new business failures is nearly doubled. Yet, as he points out, the freedom to fail – in recognition of the importance of the process of trial and error to business breakthroughs – is essential to economic progress. A free society respects the individual's freedom to pursue their goals, using the resources available to them, on equitable terms without intrusion. While entrepreneurial successes move society forward, failures also play an important role, by freeing up productive resources for new ventures. Short-circuiting the trial and error process so necessary to innovation ultimately prevents the accrual of benefits from successive entrepreneurship: a strong entrepreneurial economy will therefore not intervene to slow or prevent failure.

STIFLING ENTREPRENEURSHIP

For Hall, the biggest challenge in his work has been exploring the specific factors that trigger higher levels of business innovation in some countries or US states than in others: "In large panel datasets we are pretty good at establishing correlation, but identifying the causal mechanisms by which changes in economic freedom lead to more entrepreneurship are more difficult," he says.

Hall has further explored how the nature of federal and state policies and institutions, and the levels of control

they impose on the individual, fundamentally affect entrepreneurship. He claims that government schemes such as providing subsidized loans and tax incentives for start-ups and programmes to stimulate innovation are self-defeating; in such circumstances, many entrepreneurs will spend their time unproductively (from society's viewpoint), i.e. in lobbying or currying favour with public officials.

Centralized government planning of entrepreneurial activity through devices like tax credits and subsidies also merely serves to distort the markets and introduce inequities. Instead of developing institutions and mechanisms specifically designed to nurture entrepreneurship, government policies should simply create the kind of economic climate in which entrepreneurs can flourish: policies that protect people's rights to property and capital from plunder, that make contracts equitably enforceable, and that provide a stable monetary environment with little fluctuation in the money supply and value. Under the economic freedom that results, entrepreneurs can spend their time productively, making the most of the resources available to them for meeting new customer needs and for creating wealth. As Hall explains it, entrepreneurship is the mechanism through which institutions are translated into economic growth.

A documentary *Economic in Action: Changing Lives* based in part on Professor Hall's work played nationwide on public television in 2013.



FREEDOM, ENTREPRENEURSHIP AND ECONOMIC GROWTH

RESEARCH INTERESTS

- To understand the areas of economic freedom that are most conducive and/or negatively related to entrepreneurship
- To examine the relationship between economic freedom and entrepreneurship across US states and across nations

KEY COLLABORATORS

- **Dr Russell Sobel**, The Citadel, South Carolina, USA
- **Dr Robert Lawson**, Southern Methodist University, Texas, USA
- **Dr Justin Ross**, Indiana University, Indiana, USA
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JOSHUA HALL is an associate professor of economics and co-director of the Center for Free Enterprise at West Virginia University. He earned his bachelor and master degrees in economics from Ohio University and his PhD from West Virginia University in 2007. Prior to returning to his alma mater, he was the Elbert H Neese, Jr. Professor of Economics at Beloit College and an Economist with the Joint Economic Committee of the US Congress. Hall is currently serving as the President of the Association of Private Enterprise Education. He is author of over 100 academic journal articles, book chapters, and

scholarly studies and is editor of *Homer Economicus: The Simpsons and Economics* (Stanford University Press, 2014).

EMERALD AFFILIATION

Editor-in-Chief, *Journal of Entrepreneurship and Public Policy*